EXHIBIT 3
DATE 02/05/07
HB 63

House Bill 63 -- PROPOSAL TO ACTUARIALLY FUND THE TEACHERS' RETIREMENT SYSTEM

Sponsor: Representative John Musgrove

By Request of the Teachers' Retirement Board

Testimony in support presented by David L. Senn, Executive Director
444-3376

Constitutional & Funding Requirements

The Montana Constitution, Article VIII, Section 15, requires all public retirement systems be actuarially funded. The Board's Funding Policy states that whenever the amortization period of the unfunded liabilities for two consecutive valuations are projected to exceed 30 years through the use of long term cash flow projections, or the funded ratio is less than 85%, and the Board cannot reasonably anticipate that the amortization period would decline or the funded ratio improve without an increase in funding sources, it is the obligation of the Board to recommend to the legislature that funding be increased and/or liabilities be reduced. This proposal includes amendments to both increase funding and reduce liabilities.

The July 1, 2006, valuation shows that current contribution rates will not amortize the unfunded liability over any period of time and that the funded ratio is only 76%. A contribution rate increase of 3.38%, or a combination of rate increases and cash infusions are required to make the system actuarially sound. The Legislature must also eliminate loopholes that put stress on the actuarial soundness of the System, otherwise continued contribution rate increases, and/or cash infusions will be required to maintain the actuarial soundness of the TRS.

In their 2005 and 2006 audits of the TRS, the Legislative Auditor recommended, "legislation be enacted to provide funding to ensure the Teachers' Retirement System is funded on an actuarially sound basis, as required by the Montana Constitution". This proposal includes funding to fund the TRS on an actuarially sound basis.

This proposal was reviewed and approved by the Sate Administration and Veteran's Affairs Interim Committee.

- **New funding sources - (Sections 1, 2, 6 & 11)**

The proposal to actuarially fund the System includes a one-time infusion of $100 million, plus two graded contribution rate increases: 2.0% effective July 1, 2007, and an additional 0.38% increase on July 1, 2009. These rates will be paid by the Sate General Fund and will not be passed on to school districts, i.e., this proposal will **NOT** increase property taxes.

- **<u>Eliminate the statutory minimum rate of interest that may be credited by the Board – (Section 5)</u>**

- Given the market declines of the past few years, this rate should be set by the Board using a prudent standard related to market return. It is not reasonable to credit 4.0% interest if the system is making less than 4.0%.

- **<u>Increase the MUS ORP supplemental contribution rate – (Section 7)</u>**

The University System's Optional Retirement Plan (ORP) supplemental contribution rate must be increased 0.68%, from 4.04% to 4.72% if their unfunded liabilities that existed when the ORP was created are to be amortized by July 1, 2033, as required by current law. Without this increase, the TRS would not be actuarially sound.

- **<u>Eliminate the statutory requirement that the Board increase GABA to 3.0% as funds become available – (Section 9)</u>**

It is unrealistic to expect the Board to increase benefits when the legislature has not provided the additional revenue needed to fund the benefit enhancement. Under current law, any increase made by the TRS Board would create additional unfunded liabilities, with no additional funding to pay for them other than future excess investment earnings. This changes will not reduce the 1.5% GABA paid to all current and future retirees.

- **<u>Close loopholes that create additional unfunded liabilities – (Sections 3, 4 & 10)</u>**

<u>Clarify the State's policy on Teachers' Retirement</u> – Clarify that it is the state's policy to provide equitable benefits based on the member's normal service and salary and to limit spiking and double dipping opportunities.

*The following two proposed changes will affect retirees who return work in a position covered under the Teachers' Retirement System. Under TRS statutes, a retiree may return to work in a **part time** position and earn up to the greater of **1/3** of the median average final compensation of those retired in the preceding fiscal year, or an amount not to exceed **1/3** of their average final compensation, plus CPI increases.*

<u>Revising the definitions of full-time and part-time service</u> – Full-time service is currently defined as "service that is full–time and that extends over a normal academic year of at least 9 months". Under this proposal, full-time service would be defined as 180 days or 140 hours per month over at least 9 months; part-time service would be defined as service that is less than full-time. Clearly defining part-time service will close the loophole currently used by retirees to work essentially full-time after retirement in a TRS eligible position. In fact, we recently discovered that a few of these "working retirees" have been reported as being employed full-time on their employer's Annual Data Collection (ADC) report submitted to OPI, and "part-time" for TRS purposes.

In September 2006, we followed-up with several districts that had reported working retirees on their 2005 ADC report as being employed full-time, while reporting these

- **<u>Eliminate the statutory minimum rate of interest that may be credited by the Board – (Section 5)</u>**

- Given the market declines of the past few years, this rate should be set by the Board using a prudent standard related to market return. It is not reasonable to credit 4.0% interest if the system is making less than 4.0%.

- **<u>Increase the MUS ORP supplemental contribution rate – (Section 7)</u>**

  The University System's Optional Retirement Plan (ORP) supplemental contribution rate must be increased 0.68%, from 4.04% to 4.72% if their unfunded liabilities that existed when the ORP was created are to be amortized by July 1, 2033, as required by current law. Without this increase, the TRS would not be actuarially sound.

- **<u>Eliminate the statutory requirement that the Board increase GABA to 3.0% as funds become available – (Section 9)</u>**

  It is unrealistic to expect the Board to increase benefits when the legislature has not provided the additional revenue needed to fund the benefit enhancement. Under current law, any increase made by the TRS Board would create additional unfunded liabilities, with no additional funding to pay for them other than future excess investment earnings. This changes will not reduce the 1.5% GABA paid to all current and future retirees.

- **<u>Close loopholes that create additional unfunded liabilities – (Sections 3, 4 & 10)</u>**

  <u>Clarify the State's policy on Teachers' Retirement</u> – Clarify that it is the state's policy to provide equitable benefits based on the member's normal service and salary and to limit spiking and double dipping opportunities.

  *The following two proposed changes will affect retirees who return work in a position covered under the Teachers' Retirement System. Under TRS statutes, a retiree may return to work in a **part time** position and earn up to the greater of **1/3** of the median average final compensation of those retired in the preceding fiscal year, or an amount not to exceed **1/3** of their average final compensation, plus CPI increases.*

  <u>Revising the definitions of full-time and part-time service</u> – Full-time service is currently defined as "service that is full–time and that extends over a normal academic year of at least 9 months". Under this proposal, full-time service would be defined as 180 days or 140 hours per month over at least 9 months; part-time service would be defined as service that is less than full-time. Clearly defining part-time service will close the loophole currently used by retirees to work essentially full-time after retirement in a TRS eligible position. In fact, we recently discovered that a few of these "working retirees" have been reported as being employed full-time on their employer's Annual Data Collection (ADC) report submitted to OPI, and "part-time" for TRS purposes.

  In September 2006, we followed-up with several districts that had reported working retirees on their 2005 ADC report as being employed full-time, while reporting these same folks to TRS as working part-time. While there were many reasons, most often we were told that their OPI report was in error, we also received several responses similar to the following:

> The ADC report was filed with OPI to indicate the position was based on a fulltime service for the 240 days of the stated contract, not fulltime of a normal 260-day contact use for TRS reporting purposes.

A preliminary review of the 2006 ADC data shows over 40 retirees in full time positions, and many are the same retirees reported as working full time in 2005. The ADC reports and the responses we received clearly demonstrated the need to define what constitutes part time service under the Teachers' Retirement System.

<u>Clarifying the maximum amount of compensation a retired member may earn under certain circumstances</u> - During any school year 500 – 600 retirees are reported to TRS as having returned to work in a part-time position. Our review of the ADC reports and DLI wage records indicates that there may be as many as 1,200 retirees returning to work each year. Most only work a few days, but a few work the entire year in positions paying the maximum they can earn under TRS statutes, **PLUS** additional fringe benefits excluded from the definition of earned compensation under §19-20-101(6), MCA. This practice results in benefits being paid before a member actually terminates and retires, thus increasing the total benefits paid by the System and in turn increasing the unfunded liabilities of the TRS. The proposed amendments would include fringe benefits in the maximum salary retirees can earn in a TRS eligible position.

<u>Why is closing these loopholes important?</u>

Today, only around 20% of the TRS members retire when they are first eligible. If 100% members were able to start drawing benefits when first eligible and continue working in a TRS covered position, 80% would be under funded, and contributions would need to increase at least another 3.0%, or around $20 million per year.

I mentioned that in addition to comparing our retiree database with the OPI ADC report, we also compared our retirees to wage reports from the Department of Labor. Again, the preliminary review found over 50 retirees with wages reported to DLI that were greater than the maximum the retiree was eligible to earn under TRS statutes. The highest wages in this group exceed $70,000, and this was for someone who was eligible to earn $27,664 under 19-20-731, MCA. The difference is fringe benefits not reported as compensation to TRS.

Essentially these loopholes provide the opportunity for a few members to continue working almost full time, receive a full salaries and full retirement benefits. If these loopholes are not addressed by this legislation, or in other bills, the funded ratio of the TRS will continue to decline, and additional contributions will be required.

The Teachers' Retirement Board asks that you give HB 63 a do pass recommendation and resist all amendments which would remove the loophole closures.